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Forbes

IF THE DOLLAR DROPS FARTHER-

WHAT SHOULD INVESTORS DO?

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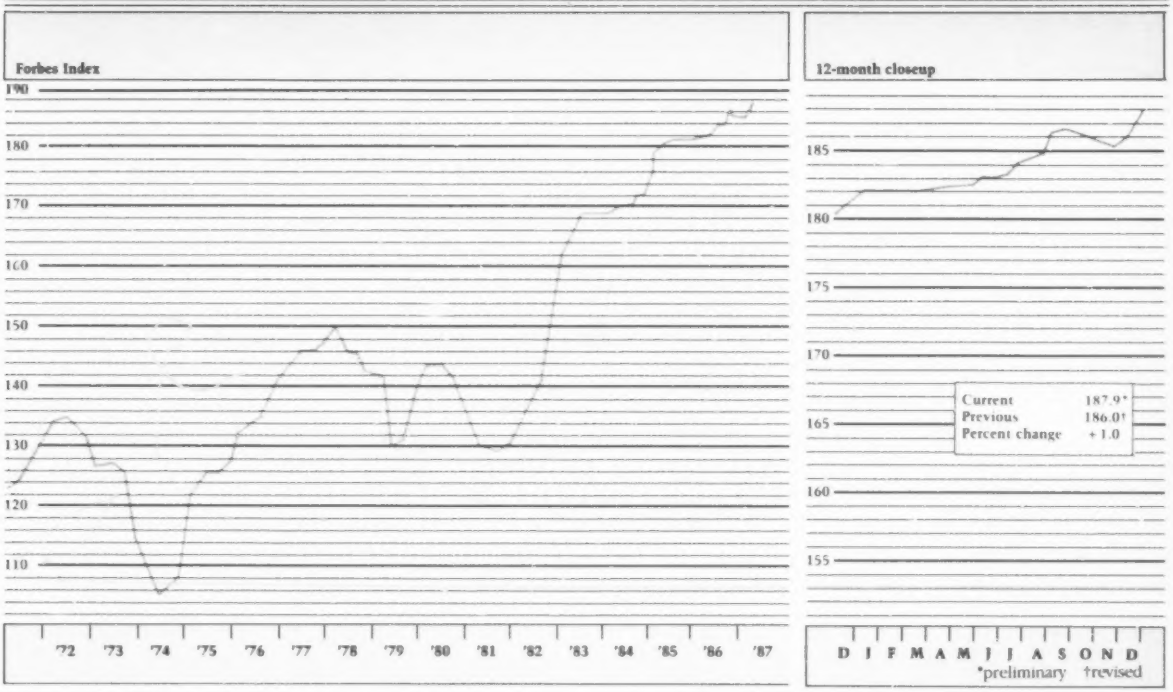
The Forbes Index



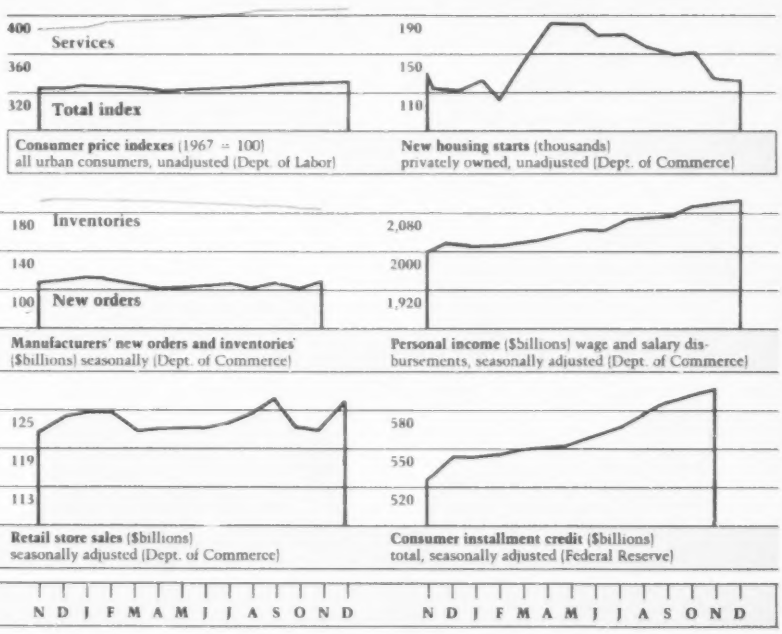
Help from a falling dollar. The Forbes Index went up 1% during the latest reporting period, hitting yet another record high. A weaker dollar finally seems to be having some impact on industrial production. That component of the Forbes Index rose 0.5% in December, following advances of 0.6% in November and 0.3% in October. Among the strongest sectors were consumer goods and nondurable materials, both sensitive to international competition, and defense, which is not.

Personal income also helped the Index, rising 0.3% from November to December. Construction, however, remains weak. New housing starts fell by 1.6% in December and were 5.4% lower than a year ago. And the new tax law will probably hurt commercial construction.

The Forbes Index Components

The Forbes Index is a measure of U.S. economic activity composed of eight equally weighted elements. Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, total consumer installment credit.

To measure these eight elements, Forbes monitors ten series of U.S. government data. The last 14 months' data for each series are presented at right.



Consumer price indexes (1967 = 100) all urban consumers, unadjusted (Dept. of Labor)

New housing starts (thousands) privately owned, unadjusted (Dept. of Commerce)

Industrial production index (1967 = 100) seasonally adjusted (Federal Reserve)

Manufacturers' new orders and inventories ($billions) seasonally (Dept. of Commerce)

Personal income ($billions) wage and salary disbursements, seasonally adjusted (Dept. of Commerce)

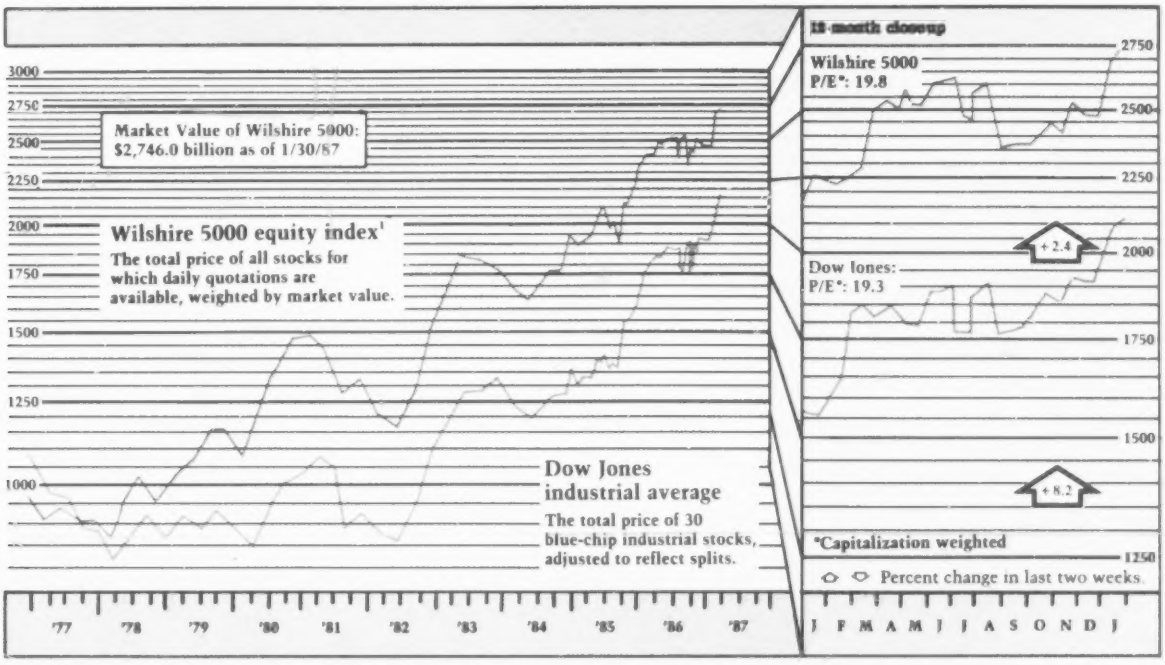
Unemployment claims average for month (thousands) seasonally adjusted (Dept. of Labor)

Retail store sales ($billions) seasonally adjusted (Dept. of Commerce)

Consumer installment credit ($billions) total, seasonally adjusted (Federal Reserve)

The Forbes/Wilshire 5000 Review

Edited by Steve Kichen



A good cheap stock is hard to find. With the Wilshire jumping 12.6% and adding more than $300 billion in market capitalization since the start of the year, the average stock now sells at nearly 20 times earnings (last 12 months). Even The Forbes Sales 500 sport a P/E multiple of 18.2. True, Wall Street is expecting higher earnings this year. The Forbes 500 list is now selling at 13 times the earnings that security analysts expect these big companies to haul in this year. But if past years are a guide, analysts will reduce their earnings estimates as 1987 progresses, keeping the multiple up in the sky.

Some secondary stocks, particularly those trading on the Nasdaq, seem less overvalued than the blue chips *(see story, p. 154)*. While the Dow gained 3.9% in the last two weeks, Nasdaq shares rose only 0.6%. Over the last year the Nasdaq is up only 16.8%, vs. 37.4% for the Dow. The Amex, however, seems to be catching up. Amex shares shot up 3.3% during the last ten trading days.

Closeup On The Equity Markets

Performance of six leading indexes

Percent change	Wilshire 5000	Forbes 500[2]	Dow Jones industrials	NYSE Composite	Amex Market Value Index	NASDAQ Composite
in last 4 weeks	10.8	10.7	12.0	10.7	12.3	11.0
in last 52 weeks	25.6	22.8	37.4	27.8	23.2	16.8

Stock performance based on six key investor yardsticks

Percent change	Company size		Volatility[3]		P/E multiple		Dividend yield		Growth profile[4]		Share price	
	large	small	high	low	over 25	under 5	over 7.5%	none	high	low	over $40	under $4
in last 4 weeks	11.0	12.1	17.0	7.2	11.5	8.5	6.7	13.3	17.3	7.6	9.8	11.6
in last 52 weeks	28.9	37.9	52.9	28.0	19.3	24.6	21.0	35.6	47.8	29.5	31.6	21.0

[1]Wilshire index reflects price performance. It differs slightly from market value of outstanding stocks because of retirements of equity since index was created. [2]Based on sales. [3]A stock's sensitivity to overall market movement. High-volatility issues have wide price fluctuations, low-volatility issues are more stable. [4]A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

Note: All data for periods ending 1/30/87. Prepared by Wilshire Associates, Santa Monica, Calif.

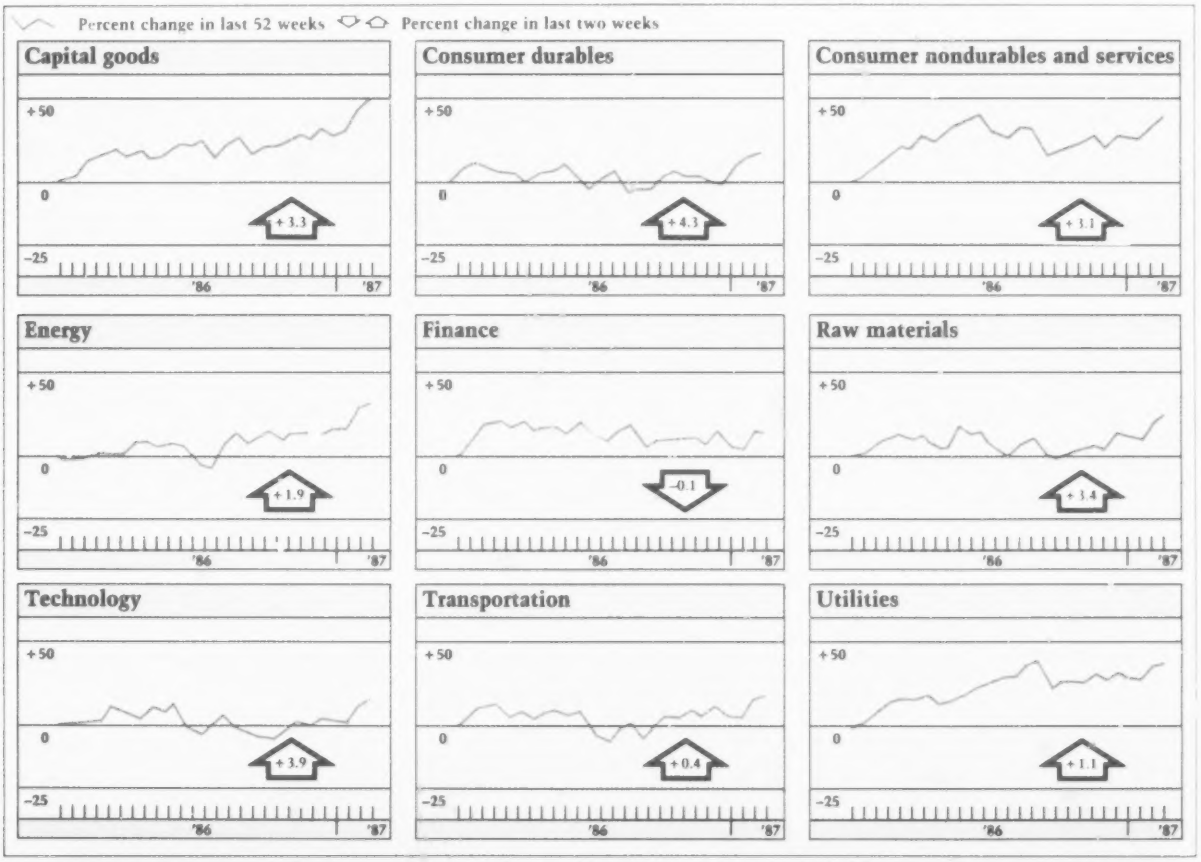
Gus French

Where The Action Is

Freedom's rewards. Goodyear Tire, which had to restructure to fend off takeover terror Jimmy Goldsmith, went up 11% in the last two weeks. The firm invited the tender of 40 million common shares in a stock buyback. Goodyear's rise helped consumer durables gain 4.3%.

The sector that includes services was one of the top four-week performers. Home Shopping Network *(see p. 40)*, which markets consumer products over its own cable-TV networks, went up 43% on hopes for its planned acquisitions of Baltimore Federal Financial and COMB, its biggest competitor.

Finance was the worst-performing group over the last two weeks. This sector was dragged down by Salomon, off 12%, and Meridian Bancorp, off 11%.



What The Analysts Think

No prisoners. Wall Street analysts chopped 1987 earnings estimates for eight out of the nine sectors. Only the consumer durables group, revised slightly upward, was spared. But there may still be some bargains. The finance, utilities and consumer durables sectors currently sell for estimated 1987 P/Es under that of the Forbes Sales 500.

Forecasting the Forbes 500

Performance period	Average earnings per share	P/E
latest 12 months	$2.62	18.2
1987 estimates	3.67	13.0
1988 estimates	4.66	12.4

NA: Not available.

Rank based on change in estimate	Sector	Estimated 1987 EPS	Estimated 1987 P/E	% change in 1987 estimate in 2 weeks	% change in 1987 estimate in 4 weeks
1	Consumer durables	$3.56	12.8	0.04%	-0.80%
2	Finance	3.75	9.2	-0.01	-0.05
3	Energy	2.36	16.2	-0.16	-0.68
4	Utilities	3.39	10.6	-0.27	-0.36
5	Consumer non-durables	2.44	15.9	-0.30	-0.76
6	Raw materials	2.35	15.4	-0.54	-0.78
7	Transportation	2.51	13.0	-0.88	-6.72
8	Technology	2.94	14.6	-1.3[illegible]	-2.04
9	Capital goods	2.61	16.3	-1.46	-1.77

Earnings projections are capitalization-weighted consensus estimates from over 2,000 security analysts. Data are compiled and updated continuously by the Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan, a New York-based brokerage firm.

Note: All data for periods ending 1/30/87. Prepared by Wilshire Associates, Santa Monica, Calif.; IBES, a service of Lynch, Jones & Ryan, New York.

The Forbes/TUCS Institutional Portfolio Report

Edited by Steve Kichen

Value players did well last year, according to Santa Monica, Calif.-based Wilshire Associates' most recent survey of pension fund managers.

Doesn't every portfolio manager like to think of himself as a buyer of undervalued securities? Sure, but here the category refers specifically to managers who focus on such fundamental criteria as book value and cash flow. For the 12 months through December, equity managers with this style delivered a total return of 19.1%. That compares with the 18.6% return on the S&P's 500 stocks and 16.1% on the broader Wilshire 5000 index.

Interestingly, given the value players' performance, many managers are adding more risk to their portfolios. At year-end the median pension fund manager had a portfolio of stocks with an average price/earnings ratio of 18. The Wilshire index' P/E was 17.4. And pension fund stocks were selling at an average 2.8 times book value, compared with 2.3 times book for the Wilshire index. Since year-end, of course, the multiples have climbed even higher.

These revelations come courtesy of the Trust Universe Comparison Service, a Wilshire survey that collects data on some 1,000 pension funds whose combined assets make up about a fourth of the country's $1.6 trillion total pension assets.

What was the worst performing style of equity management in 1986? It was what Wilshire calls "emerging growth," meaning shares of more speculative, mostly over-the-counter stocks, frequently high-tech companies. This style produced a median return of only 12.4%. Small growth companies still cost more (in terms of their earnings multiples) than the rest of the market, but their premium is much smaller than usual *(see story, p. 154)*.

The median return for all institutional stock managers was 18.5%, including dividends, a bit better than the 16.1% return on the Wilshire 5000 but slightly worse than the return on the S&P's 500, which underweights smaller companies.

The table at right, "Segment performance and cash flows," shows where the pros are moving money. Overall, companies have been taking more money out of their pension funds than they've been putting in, as the –4.5% figure shows. Assets of the funds nonetheless increased, since the withdrawal rate was more than compensated for by strong results in both stocks and bonds.

How different managers performed

Manager style	Total return recent quarter	12 months	24 months[3]
Diversified	4.3%	17.2%	23.3%
Growth	4.7	15.4	22.9
Growth—emerging	3.8	12.4	21.3
Market timer	3.7	16.9	21.1
Sector rotator	4.2	15.5	21.9
Value	4.1	19.1	24.1

Where the institutions put their money

Segment	Portfolio weighting—most recent quarter	previous quarter
Equity	54.6%	54.2%
Fixed income	32.3	33.0
Cash and equivalents	9.9	9.5
Convertibles	0.8	0.8
Other[1]	2.6	2.5

Equity portfolio characteristics

	Institutional portfolios	Wilshire 5000
Price/earnings ratio	18.0	17.4
Dividend yield	2.8%	3.6%
Beta[2]	1.01	1.06
Price/sales	1.14	1.09
Price/book	2.77	2.33

Segment performance and cash flows

Segment	Most recent quarter—median total return	Most recent quarter—shift in institutional holdings	Latest 12 months—median total return	Latest 12 months—shift in institutional holdings
Equity	4.6%	–1.6%	18.0%	–8.5%
Fixed income	3.4	–3.6	15.0	–1.2
Cash equiv	1.5	4.2	7.0	–2.9
Convertibles	2.9	–7.1	15.4	–26.8
Other[1]	2.7	2.7	10.6	–5.8
Total	4.4	–2.9	18.5	–4.5

Position changes: These securities had the greatest relative change in holdings over the last quarter

Security	Increase in holdings	Total quarter return	Security	Decrease in holdings	Total quarter return
General Electric	3.5%	20.5%	IBM	–4.9%	–10.0%
Eastman Kodak	2.2	30.1	Unisys	–3.8	15.1
Halliburton	2.1	13.2	JP Morgan	–2.1	2.5
Exxon	2.0	5.6	Goodyear Tire	–2.0	21.1
AT&T	1.8	11.2	Boeing	–1.4	–3.6
Merck	1.7	26.4	Intl Paper	–1.4	11.4
May Dept Stores	1.4	7.1	Gannett	–1.1	5.2
SmithKline Beck	1.3	19.0	Amer Intl Group	–0.8	–0.7
Nynex	1.1	4.8	General Re	–0.8	–2.7
Waste Mgmt	1.0	15.6	Transamerica	–0.8	–0.4

[1]Real estate, foreign investments, venture capital, guaranteed insurance contracts. [2]A measure of risk. A stock with a beta of 1.00 tends to move up or down at the same rate as the S&P's 500. [3]Figures for 24 months are annualized.

Note: Data for quarter ending 12/31/86. Prepared by the Trust Universe Comparison Service (TUCS®), a service of Wilshire Associates, Santa Monica, Calif.

Where the institutions are—and aren't

Most overweighted relative to Wilshire 5000			Most underweighted relative to Wilshire 5000		
	% of			% of	
Security	institutional universe	Wilshire 5000	Security	institutional universe	Wilshire 5000
Digital Equipment	1.2%	0.8%	Exxon	0.9%	3.0%
Halliburton	0.3	0.2	IBM	2.4	4.3
General Re	0.5	0.3	AT&T	0.4	1.6
ITT	0.6	0.4	British Petroleum	0.2	1.2
SmithKline Beckman	0.6	0.4	Royal Dutch Petroleum	0.6	1.5
Federated Dept Stores	0.4	0.2	General Electric	1.4	2.3
Waste Management	0.5	0.3	BellSouth	0.4	1.1
Cray Research	0.3	0.1	EI du Pont de Nemours	0.5	1.2
Apple Computer	0.3	0.2	Amoco	0.5	1.0
Philip Morris	1.1	1.0	General Motors	0.7	1.2

IBM remains the largest institutional holding, but it is falling out of favor. In three of the last four quarters IBM has been at or near the top of the list of stocks with the greatest decline in institutional ownership. Smaller investors had difficulty picking up the slack on a stock that had a year-end market capitalization of more than $73 billion: The price of IBM shares fell 22.8% in 1986. Also on the hit list were transportation stocks. During the fourth quarter the transportation sector fell from 4.2% to 3.7% of the institutional portfolio. In this group AMR and UAL posted the biggest drops in holdings.

General Electric shows the greatest increase in institutional holdings. But GE is still significantly underweighted in institutional portfolios.

Sector activity and top holdings

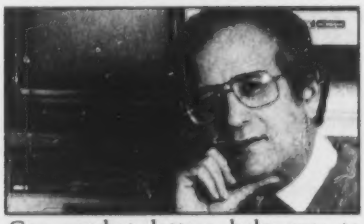
% of institutional portfolio: ■ most recent quarter ■ previous quarter

Capital goods	4.5% 4.9%	Consumer durables	4.8% 5.2%	Consumer nondurables	28.4% 28.7%
	total return		total return		total return
General Electric	20.5%	General Motors	–0.9%	Philip Morris	9.6%
Emerson Electric	4.9	Ford Motor	7.3	Merck	26.4
Westinghouse Electric	6.8	Chrysler	3.7	Eastman Kodak	30.1
Caterpillar Tractor	6.3	Goodyear Tire & Rubber	21.1	SmithKline Beckman	19.0
Cooper Industries	3.1	Whirlpool	14.8	Wal-Mart Stores	10.8
Energy	9.7% 9.1%	Finance	13.9% 12.6%	Raw materials	13.3% 12.6%
	total return		total return		total return
Exxon	5.6%	American Express	1.3%	EI du Pont de Nemours	5.8%
Royal Dutch Petroleum	7.3	General Re	–2.7	Waste Management	15.6
Mobil	8.6	American Intl Group	–0.7	Monsanto	13.4
Amoco	1.9	Citicorp	7.0	Dow Chemical	10.0
Chevron	4.5	Aetna Life & Casualty	–0.6	Allied-Signal	–0.1
Technology	14.8% 15.7%	Transportation	3.7% 4.2%	Utilities	6.9% 7.0%
	total return		total return		total return
IBM	–10.0%	Norfolk Southern	7.9%	Pacific Telesis Group	3.1%
Digital Equipment	16.6	AMR	–5.5	Nynex	4.8
ITT	10.3	CSX	7.0	Southwestern Bell	7.5
Minnesota Mng & Mfg	16.9	Union Pacific	10.6	GTE	12.1
Hewlett-Packard	8.9	Federal Express	–3.3	AT&T	11.2

Most traders don't believe that market letters can help them make money. Objective evidence says that is not true.

MAILBOX MAVENS

By Stanley W. Angrist



Can market letters help you to make money in futures? Considerable help is available in answering that question from Bruce Babcock's *Commodity Traders Consumer Report.* This bimonthly tracks 26 market letters, with an annual review issue. Last year's results have just been published, and I will summarize them here. Since consistency is nearly everything in commodity trading, the table here gives the record for those letters whose recommendations did well last year and in 1984 and 1985. Four were not published in all three years.

A number of letters that ranked well in the previous two years no longer are listed. Most notable is the *TASAS* letter, started by Craig Pardey, which was ranked number one in nearly every dimension in 1984. Pardey quit publishing his letter in 1985 and began managing a pool of money based on his proprietary trading system. In August 1986 he elected to close down his pool after the average equity of each account had dropped to $13,000, from an initial value of $35,000. (Most of the original investors in his pool made money because there had been interim profit disbursements between inception and shutdown.)

And yet, as the table reveals, there are several market letters that have been able to generate profitable records for two or, in some cases, three years. One of the most ways to evaluate the performance of a market letter is to look at the profit per trade. This number is arrived at by computing the profits generated after all losses and dividing the result by the total number of trades. (Trades open on Dec. 31 are assumed to be closed at that day's end.) I then deducted $100 per trade from the profit per trade to allow for commissions and slippage.

Because commodity speculation is such a difficult activity, traders frequently look for psychological reinforcement by seeking to maximize the percentage of profitable trades. As the table indicates, such a percentage is not necessary in order to reap substantial profits.

When following the advice of a market letter, if you want to show the same profits as the letter, you must take all trades recommended. No one is smart enough to pick only the winners. *CTCR* estimates the required margin to take each trade that a letter writer suggests and then computes the return you would have achieved based on that margin. But in order to allow for the fact that not everyone can get exchange minimum margins, *CTCR* doubles the minimum margin required when computing the return. Some letters, indeed, have achieved impressive results. In choosing a service, it is not enough to pick the one that has the best performance numbers; more important is to choose one that is compatible with your own trading style.

You can learn more about these market letters by subscribing to *CTCR* (916-677-7562).

The six-month-long rally in cotton that has seen the price of that commodity almost double since June has been breathtaking to observe. However, I believe that cotton could again become a carrying-charge market. Therefore, I would try to put on a spread of long July/short May, with July at no more than a 10-point premium to May. Look for the spread to widen at least 100 points ($500) per spread and risk no more than 60 points ($300) per spread, with both target and stop calculated from your entry position. The margin on this spread is about $500, and the round-turn commission at a discounter, $40 or so. ■

Stanley W. Angrist is a commodity speculator, consultant and longtime observer of the commodity markets.

Profits from the post office

Listed below are abbreviated performance records for eight market letters that had respectable records last year. These letters can be used as valuable trading tools. In computing the profit per trade, $100 has been subtracted to allow for commissions and slippage. Extensive details on these and other letters are available from *Commodity Traders Consumer Report.*

Market Letter	1986 P	1986 %	1986 R	1985 P	1985 %	1985 R	1984 P	1984 %	1984 R
The Timing Device	$772	38	107%	–	–	–	–	–	–
The Elliott Wave Theorist	669	59	82	$ 9	42	2%	$292	50	67%
DeMark Futures Forecast	497	53	115	114	51	77	–	–	–
The Bullish Consensus	437	53	91	310	51	102	–	–	–
Kimball Letter	320	40	19	–343	40	–23	69	38	12
Dines Commodity Letter	215	29	16	42	33	9	–	–	–
Accu Comm Futures	100	46	58	123	63	39	118	76	25
Commodity Timing	71	41	56	–30	40	–17	63	45	9

P: Profit per trade. %: Percent profitable trades. R: Return on margin.